

## Should Foreign Exchange be Foreign to Article Two of the Uniform Commercial Code

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## Should Foreign Exchange Be “Foreign” to Article Two of the Uniform Commercial Code?

### Introduction

In 1988, the Permanent Editorial Board for the Uniform Commercial Code commissioned a study group to recommend revisions to the centerpiece of the Code—Article 2 on sales.<sup>1</sup> The group issued a report that identified recurring problems with the existing Article and proposed a number of changes. The group noted, among other concerns, that courts have experienced some difficulty in defining the scope of Article 2.<sup>2</sup>

The existing statutory language has not given the courts much guidance. Section 2-102 states simply: “Unless the context otherwise requires, [Article 2] applies to transactions in goods.”<sup>3</sup> Yet, the Code does not define “transaction” and leaves obscure the phrase: “unless the context otherwise requires.”<sup>4</sup> Other sections of the Code further confuse the issue. For example, some sections seem to limit their reach exclusively to sales,<sup>5</sup> leaving courts in doubt as to whether these sections apply to other forms of exchange such as franchising or licensing arrangements.<sup>6</sup> Conversely, other sections bearing on the scope of Article 2 appear to have an almost limitless reach. For example, courts have applied the Code’s defi-

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1. PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP UNIFORM COMMERCIAL CODE ARTICLE 2 PRELIMINARY REPORT (1990) [hereinafter STUDY GROUP REPORT]. Article 2 was drafted by Karl Llewellyn, the chief reporter of the Uniform Commercial Code. In many respects the Code reflects his vision. See WILLIAM TWINING, KARL LLEWELLYN AND THE REALIST MOVEMENT 270-340 (1973); Soia Mentschikoff, *Reflections of a Drafter*, 43 OHIO ST. L.J. 537 (1982); William A. Schnader, *A Short History of the Preparation and Enactment of the Uniform Commercial Code*, 22 U. MIAMI L. REV. 1, 4 (1967).

2. STUDY GROUP REPORT, *supra* note 1, at 37-44.

3. U.C.C. § 2-102 (1993).

4. STUDY GROUP REPORT, *supra* note 1, at 40.

5. See, e.g., U.C.C. §§ 2-312, 2-314 (1993).

6. See, e.g., *Vigano v. Wylain, Inc.*, 633 F.2d 522, 525-26 (8th Cir. 1980) (refusing to apply Article 2 to a distributorship agreement under Missouri law); *Zapatha v. Dairy Mart, Inc.*, 408 N.E.2d 1370, 1375 (Mass. 1980) (applying Article 2 to a franchise agreement).

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inition of the term "goods" to reach transactions involving computer software,<sup>7</sup> personal services,<sup>8</sup> and, as we shall see, foreign currency exchange.<sup>9</sup>

This confusion led the study group to recommend that the proposed Article 2 revisions should help to clarify the Article's scope.<sup>10</sup> The group could not agree, however, on just how far to expand or constrict Article 2's reach. Some members of the group favored narrowing the Article's scope, while others thought a revised Code should reach well beyond the standard sale of goods.<sup>11</sup> The drafting committee appointed to prepare a revised Article 2 seems to favor the latter approach. As of this writing, the committee appears to envision a revised article that sets forth core provisions in part 1 applicable to all sorts of contracts, followed by other parts dealing with particular transactions such as software and even services.<sup>12</sup> The committee has likened the approach to a wheel, with the core provisions as its "hub" and the transaction specific provisions as its "spokes."<sup>13</sup>

This article reviews a line of cases that suggests limits to the expansion of Article 2. The cases involve foreign exchange transactions: the trading of bank balances denominated in one national currency for those denominated in another. Part I of this article describes the conduct of foreign exchange and its importance in international trade. Part II criticizes judicial decisions that have applied Article 2 to these transactions. Article 2 is criticized as a poor vehicle for regulating these exchanges. The Article was not drafted with foreign exchange in mind, and has rules of form—such as a statute of frauds—that create problems for foreign exchange transactions. Moreover, the Article has remedies—such as the right of a seller to reclaim goods—that minimize the importance of finality, a policy of central importance to foreign exchange. Part III of this article suggests how a revised Article 2 should define its scope.

This Article concludes that Article 2 should narrowly confine its scope to the sale of goods, but that it should also contain an expansion clause that would allow courts to apply its provisions by analogy to other transactions. The commentary should direct a court faced with a scope question

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7. *E.g.*, *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 546-47 (9th Cir. 1985); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738 (D.N.J. 1979), *aff'd*, 635 F.2d 1081 (3d Cir. 1980). *See generally* Andrew Rodau, *Computer Software Contracts: A Review of the Caselaw*, 21 AKRON L. REV. 45 (1987).

8. *E.g.*, *Newmark v. Gimbel's Inc.*, 258 A.2d 697, 701 (N.J. 1969) (applying the U.C.C. to a transaction involving a beautician's services); *Vitomar Piece Dye Works v. Lawrence of London, Ltd.*, 256 N.E.2d 135, 138 (Ill. App. Ct. 1969) (applying Article 2 to a contract to waterproof silk). *See generally* Crystal L. Miller, Note, *The Goods/Services Dichotomy and the U.C.C.: Unweaving the Tangled Web*, 59 NOTRE DAME L. REV. 717 (1984).

9. *See infra* notes 147-76 and accompanying text.

10. STUDY GROUP REPORT, *supra* note 1, at 40.

11. *Id.* at 41-42.

12. Amelia H. Boss & Stephen C. Veltri, *Introduction to the Uniform Commercial Code Survey: A Plea for Cooperation*, 48 BUS. LAW. 1583, 1586-87 (1993); Raymond Nimmer et al., *License Contracts Under Article 2 of the Uniform Commercial Code: A Proposal*, 19 RUTGERS COMPUTER & TECH. L.J. 281, 318-22 (1993).

13. Boss & Veltri, *supra* note 12, at 1587.

not to mechanical rules of form, such as whether the transaction involves a "sale" or a "good," but to a reasoned analogy. A court should ask whether it makes commercial sense to apply the substantive rules of Article 2 in the commercial setting involved in the dispute. Such an approach is consistent with the realist jurisprudence that informs the Code and that is one of its greatest strengths.

### I. Foreign Exchange at the End of the 20th Century

A foreign exchange transaction can consist of the exchange of dollars for pounds at Heathrow Airport, or the electronic exchange of large bank balances denominated in different currencies. Although the vacationer's face-to-face exchange is important, large transactions are far more significant. In 1992, the average foreign exchange transaction in the United States involved \$6 million.<sup>14</sup>

The scale of foreign exchange activity in 1992 was astonishing. On the basis of data collected in April 1992, the Bank for International Settlements estimated global net turnover in the world's markets at \$880 billion per day.<sup>15</sup> The United States' share of this market was \$192 billion each day.<sup>16</sup> Estimates of the amounts traded in New York alone range from forty to sixty times the turnover on the New York Stock Exchange.<sup>17</sup> Obviously, no market for hard goods—automobiles, washing machines, televisions, or airliners—approaches the size of the foreign exchange market.

The most important segment of the market remains "spot trading," which accounts for nearly half of all foreign exchange.<sup>18</sup> A "spot trade" occurs when participants in the market agree to exchange currencies within two business days.<sup>19</sup> Parties to an international trade enter the spot market when it is time to pay for the goods or services for which they have contracted.<sup>20</sup> For example, suppose a shoe store chain in Des Moines wishes to offer the latest Italian loafers for sale next summer. The Des Moines retailer contracts in March with an Italian supplier to take delivery of the shoes and pay for them on June 1. If the retailer believes the dollar will be worth more in relation to the lira in June than it is in March, or if he pays little attention to the foreign exchange dimension of his trade, he will wait until the last moment to exchange his dollars into lire to pay for

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14. BANK FOR INTERNATIONAL SETTLEMENTS, CENTRAL BANK SURVEY OF FOREIGN EXCHANGE MARKET ACTIVITY IN APRIL 1992, at 25 (1993) [hereinafter CENTRAL BANK SURVEY].

15. *Id.* at 5.

16. *Id.* at 13-14.

17. DIMITRIS N. CHORAFAS, TREASURY OPERATIONS AND THE FOREIGN EXCHANGE CHALLENGE: A GUIDE TO RISK MANAGEMENT STRATEGIES FOR THE NEW WORLD MARKETS 78 (1992).

18. CENTRAL BANK SURVEY, *supra* note 14, at 16.

19. *Id.*; see also HEINZ RIEHL & RITA M. RODRIGUEZ, FOREIGN EXCHANGE AND MONEY MARKETS 443 (1983).

20. For a general discussion of foreign exchange transactions and their role in foreign trade, see Michael L. Manire, Note, *Foreign Exchange Sales and the Law of Contracts: A Case for Analogy to the Uniform Commercial Code*, 35 VAND. L. REV. 1173 (1982).

the shoes. His bank or the seller's bank may actually make the exchange, but if it occurs within two business days it is considered a spot trade.

In an international sale, use of a spot trade carries a risk. In our example, the retailer is exposed to the risk that the lira may appreciate in relation to the dollar before he pays for the shoes. In a two to three month period, value of the lira to the dollar may fluctuate by several percentage points.<sup>21</sup> Fluctuation of even a few points can cause a significant loss in a large transaction. In the example above, the decline in the dollar from the end of March to June 1993, would have cost the Iowa retailer roughly \$6,000 in a \$100,000 order.<sup>22</sup> To cover this exposure a trader can purchase the currency he or she will need in the forward foreign exchange market.<sup>23</sup> At the time the Iowa retailer enters into the contract for the Italian shoes, or at any time before she takes delivery, she may wish to buy lire on the forward market for June 1. She thus insures against fluctuation and fixes the cost of the currency exchange she must make to buy the Italian shoes.

Forward transactions of the kind just described comprise what is known as the outright forward market.<sup>24</sup> It includes any trade that calls for the exchange of currencies outside of two business days.<sup>25</sup> Most forward trades, however, have maturities that are not much longer than two days. Nearly two-thirds of all foreign exchanges involve exchanges of currency within a week.<sup>26</sup> Only one percent of the total transactions have maturities of over a year.<sup>27</sup> The outright forward market is used heavily by merchants engaged in international trade to cover their exposure in international sales just like the shoe retailer in the example above.<sup>28</sup> This segment of the foreign exchange market has experienced considerable growth in recent years.<sup>29</sup>

In addition to the outright forward market, futures transactions can involve swaps.<sup>30</sup> In a swap, the two parties to the transaction agree to exchange currencies at an agreed rate on a given date.<sup>31</sup> At a later date they reverse the transaction, typically at a different rate.<sup>32</sup> One trader sells

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21. For example, the dollar declined approximately six percent in relation to the lira between April 1 and June 1, 1993. *Compare Key Currency Cross Rates*, WALL ST. J., Apr. 2, 1993, at C13 (listing the lira at 1586 to the dollar) with *Key Currency Cross Rates*, WALL ST. J., June 2, 1993, at C15 (listing the lira at 1465 to the dollar).

22. *Id.*

23. RIEHL & RODRIGUEZ, *supra* note 19, at 334. A "forward market" is defined as a "market in which foreign currency, and some money market instruments, are traded for future delivery." *Id.* at 435.

24. CENTRAL BANK SURVEY, *supra* note 14, at 18-19.

25. *Id.*

26. *Id.* at 19.

27. *Id.*

28. *Id.*

29. *Id.* "Growth has been rapid, with gross transactions expanding by 60% between April 1989 and April 1992 in the twelve countries reporting such data in these two years." *Id.*

30. *Id.* at 18.

31. *Id.*

32. *Id.*

the currency he or she had previously purchased, while the other trader buys the currency he or she had earlier sold.<sup>33</sup> A swap can involve a spot trade against a forward trade or two forward trades.<sup>34</sup> A trader can use the swap market to minimize financial risk.<sup>35</sup> To illustrate with the example above, the Iowa retailer has entered into an outright forward contract to buy lire on June 1. The risk of depreciation in the lira has now passed to the bank that has agreed to sell the lire. If the bank waits until June 1 to buy the lire on the "spot" market, it loses if the lira declines in value in relation to the dollar. The bank, however, can cover its exposure caused by agreeing to the forward sale of lire by agreeing to a forward purchase of lire. Such a swap, involving the bank and two other parties, is called an engineered swap.<sup>36</sup> Swaps are frequently conducted bilaterally, between two traders alone, and are then called pure swaps.<sup>37</sup> Pure swaps enable dealers active in the foreign exchange markets to position themselves for what they perceive to be the direction of the market.<sup>38</sup> For example, a trader who thinks the dollar will appreciate in relation to the lira will swap by buying dollars on the spot market and simultaneously agreeing to sell the dollars forward. If that dealer's perception of the direction of the market changes, he can close his exposed position with another swap.<sup>39</sup> Arbitraders also employ pure swaps to take advantage of different rates in different markets.<sup>40</sup>

Foreign exchange swaps are the fastest growing segment of the market.<sup>41</sup> Banks and investment firms are the most active participants in the swap market.<sup>42</sup> Most of their swaps are international, that is, they are made with a dealer in another country.<sup>43</sup> Swaps for commercial firms or "customers" made up only fourteen percent of the market in 1992, and these trades were overwhelmingly domestic.<sup>44</sup> Continued growth in the swap market can be expected in an era, such as ours, when the dollar

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33. See RIEHL & RODRIGUEZ, *supra* note 19, at 104; Barry W. Taylor, *Currency Swaps, and Related Exchange Transactions*, in INTEREST RATE AND CURRENCY SWAPS 245 (PLI Corporate Law & Practice Course Handbook Series No. 505, 1985).

34. See CHORAFAS, *supra* note 17, at 93-94.

35. CENTRAL BANK SURVEY, *supra* note 14, at 19.

36. RIEHL & RODRIGUEZ, *supra* note 19, at 105-06.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* The market continues to develop new and more sophisticated transactions. Most of these transactions—interest rate swaps, caps, floors, and collars—are beyond the scope of this article. These other transactions, however, could also be subjected to regulation by the Uniform Commercial Code under the rationale of the cases discussed *infra* notes 147-76 and accompanying text. For an excellent summary description of the market, see Daniel P. Cunningham et al., *Interest Rate and Currency Swaps and Related Transactions*, in SWAPS AND OTHER DERIVATIVES IN 1993, at 511, 515-21 (PLI Corporate Law & Practice Course Handbook Series No. B-815, 1993). For a description of arbitrage in foreign exchange, see *Miller v. Wells Fargo Bank Int'l*, 540 F.2d 548 (2d Cir. 1976).

41. CENTRAL BANK SURVEY, *supra* note 14, at 19.

42. *Id.* at 20.

43. *Id.*

44. *Id.*

floats relatively freely against the yen and the European currencies.<sup>45</sup> Ninety-five percent of all swaps include the dollar.<sup>46</sup> Forty-four percent of all swaps are between the dollar and the Japanese yen or the dollar and the German mark.<sup>47</sup> With free floating exchange rates, market activity by dealers helps keep the dollar in equilibrium with other leading currencies.<sup>48</sup>

Foreign exchange trades are conducted by telephone, telex, and other electronic means. In recent years, banks and other dealers have invested millions of dollars in foreign exchange centers that incorporate state of the art technology in telecommunications, computers, and systems software.<sup>49</sup> From a personal computer station in one of these centers, a dealer can receive up-to-date market rate information and the dealer's own position in various currencies.<sup>50</sup> The dealer can also execute trades from the same station.<sup>51</sup> Customers of banks that have established such a center can access it and participate in a twenty-four-hour market.<sup>52</sup> This technology allows for a trading volume undreamed of only a few years ago. Reuters Ltd., the leading supplier of currency trading systems, recently reported that in just one week in 1992, 1.4 million "electronic conversations" took place on its network.<sup>53</sup> Dealers have increasingly relied on automated trading systems. In 1992, automated trading systems facilitated nearly one-third of the transactions conducted by American firms.<sup>54</sup>

Foreign exchange transactions are generally settled by electronic

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45. See PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 714 (14th ed. 1992). Flexible, or "floating," exchange rates between countries exist when "the exchange rates are predominantly determined by private market forces (*i.e.*, by supply and demand) without government's setting and maintaining a particular pattern of exchange rates." *Id.* at 737.

46. CENTRAL BANK SURVEY, *supra* note 14, at 20.

47. *Id.*

48. SAMUELSON & NORDHAUS, *supra* note 45, at 714. At the beginning of this century, the major currencies were redeemable in gold. *Id.* at 712. Currencies under the gold standard could be exchanged according to their gold value. *Id.* At the Bretton Woods conference held near the end of World War II, the major industrial nations agreed to regulate exchange rates by fixing values in relation to the United States dollar as well as gold. *Id.* at 715. During the Nixon Administration the United States abandoned the Bretton Woods system, and the dollar has floated relatively freely against the yen and the European currencies ever since. See *id.* at 717. By the summer of 1993, trading in the European currencies reached the point where the managed system of exchange among those currencies, similar to Bretton Woods, no longer seemed to work. The European countries adjusted the system to allow greater fluctuation from the exchange rates pegged for each currency. See *To Fix or Float Exchange Rates*, *ECONOMIST*, Aug. 7, 1993, at 70.

49. See, e.g., *Bank-of-America-3; Unveils New Foreign Exchange Trading Center in Los Angeles*, *BUS. WIRE*, Oct. 13, 1983, available in LEXIS, Compny Library, Bwire File.

50. *Id.*

51. *Id.*

52. *Id.*

53. Paula Dwyer et al., *Reuters Sees a Blip on the Screen*, *BUS. WK.*, Oct. 12, 1992, at 62. That week's volume was "40% more than its average volume." *Id.* The increased volume was presumably triggered by the United Kingdom's inability to stay within the European Exchange Rate mechanism. *Id.*

54. CENTRAL BANK SURVEY, *supra* note 14, at 24.

funds transfers.<sup>55</sup> Returning to the example above, assume the Iowa retailer purchased lire on the spot market through his bank. The Iowa bank will exchange a dollar denominated bank balance for one denominated in lire. The retailer might then instruct his bank to wire these funds to the Italian bank that holds the account of the shoe manufacturer. There may be one or more banks that act as intermediaries between the American and Italian banks in making the transfer.<sup>56</sup> By utilizing electronic funds transfers, the Iowa retailer and his bank will settle the retailer's obligation and the necessary foreign exchange quite quickly.

In the United States, Article 4A of the Uniform Commercial Code governs electronic funds transfers between banks. The National Conference of Commissioners on Uniform State Laws and the American Law Institute promulgated Article 4A in 1989.<sup>57</sup> Since then, forty-eight states and the District of Columbia have adopted the Article.<sup>58</sup> The Federal Reserve wire transfer system (Fedwire) and the New York Clearing House Interbank Payments Systems (CHIPS) have also incorporated provisions of Article 4A in their rules.<sup>59</sup> These systems figure prominently in foreign exchange transactions.<sup>60</sup>

In addition to the foreign exchange transactions previously described, currency futures and options are also traded on exchanges such as the International Monetary Market in Chicago and the London International Financial Futures Exchange.<sup>61</sup> In a futures contract, the buyer agrees to purchase a given currency at a given maturity longer than two days.<sup>62</sup> With an option, the buyer has the right either to purchase or to sell the given currency at a time and price specified in the contract.<sup>63</sup> Exchange traded futures and options are in standardized contracts, as opposed to the negotiated bargains that make up forward contracts.<sup>64</sup> They are settled over the exchange and are thus anonymous. The exchange stands between any buyer and seller.<sup>65</sup> More currency options are traded over-the-counter than on organized exchanges.<sup>66</sup> Like swaps, they can be used to minimize financial risks. Not surprisingly, therefore, options exchanging the dollar for the yen or the German mark dominate the over-the-

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55. *Id.*

56. For a general description of an electronic funds transfer, see UNIF. COMMERCIAL CODE 2B U.L.A. Art. 4A, Prefatory Note (1991).

57. UNIF. COMMERCIAL CODE 2B U.L.A. Art. 4A, Historical Notes (1991).

58. Vermont adopted Article 4A on May 18, 1994. 1994 Vt. Laws 158. For a list of the other forty-seven states who have adopted the article, see UNIF. COMMERCIAL CODE 2B U.L.A. Art. 4A, Prefatory Note (Supp. 1994).

59. Robert G. Ballen et al., *Commercial Paper, Bank Deposits and Collections, and Other Payment Systems*, 46 BUS. LAW. 1521, 1522 (1991).

60. CHORAFAS, *supra* note 17, at 78-79.

61. *Id.* at 198-201, 214-21; CENTRAL BANK SURVEY, *supra* note 14, at 20-23.

62. CENTRAL BANK SURVEY, *supra* note 14, at 20.

63. *Id.* at 22.

64. *Id.* at 20.

65. *Id.*

66. *Id.* at 23.



counter options market.<sup>67</sup>

Foreign exchange activity and the participating banks and dealers are subject to various regulations. All persons engaged in foreign exchange must comply with federal reporting requirements.<sup>68</sup> The banks engaged in foreign exchange must comply with capital adequacy guidelines promulgated by the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. These guidelines were established by a twelve-nation accord reached in Basel, Switzerland in 1988.<sup>69</sup> Dealers who trade in currencies belong to self-governing bodies like the International Forex Association, the International Swap Dealers Association, and the British Bankers Association. These organizations have developed practice codes and standard agreements to govern foreign exchange transactions.<sup>70</sup> The Foreign Exchange Committee of the Federal Reserve Bank of New York has also promulgated trading practice guidelines and model forms.<sup>71</sup>

The macroeconomic effects of foreign exchange activity are regulated by the central banks of the nations of the world.<sup>72</sup> When the United States desires to intervene in the foreign exchange market, it does so through the foreign exchange desk of the Federal Reserve Bank of New York.<sup>73</sup> An example of this activity occurred in May 1994, when the United States, through the Exchange Stabilization Fund of the National Treasury, engaged in coordinated purchases of dollars with the central banks of sixteen nations in order to stabilize exchange rates.<sup>74</sup> Decisions of this kind are generally made at the highest level of government.<sup>75</sup>

To summarize, foreign exchange is characterized today by high volume trading of large bank balances. Most exchange transactions, whether on the spot or forward market, have very short maturities. The trading is highly automated and is conducted by the most advanced means of electronic communication. This advanced technology facilitates a very high volume of trading on a twenty-four-hour market. Dealers and others in the market generally settle their accounts by electronic funds transfers. Currency options and futures are traded both on exchanges and over the counter. Options and futures can operate like traditional foreign exchange trades in hedging against financial risks in foreign trade. Participants in the foreign exchange market are subject to varying degrees of federal regulation. The Federal Reserve and the United States Treasury

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67. *Id.*

68. See 31 C.F.R. pt. 128 (1993).

69. Cunningham et al., *supra* note 40, at 511, 536.

70. *Id.* at 525.

71. THE FOREIGN EXCHANGE COMMITTEE, ANNUAL REPORT 1991, at 5, 26-33, 36-55 (1990).

72. Thomas L. Friedman, *16 Nations Aid U.S. in Backing Value of Dollar*, N.Y. TIMES, May 5, 1994, at A1.

73. *Id.*

74. *Id.*

75. *Id.*

will occasionally intervene in the foreign exchange market to stabilize rates.

It seems odd that courts would look to Article 2 of the Uniform Commercial Code to resolve disputes involving a foreign exchange trade. Article 2, after all, was drafted in the 1940s to govern sales of hard goods,<sup>76</sup> yet the courts have rather unreflectively applied its provisions in cases involving foreign exchange.

## II. Article 2 Applied To Foreign Exchange Transactions

The text of Article 2 and its accompanying commentary are deceptively simple. The "Article applies to transactions in goods."<sup>77</sup> "Goods" are defined as "all things . . . which are moveable at the time of identification to the contract . . . other than the money in which the price is to be paid, investment securities (Article 8) and things in action."<sup>78</sup>

The official comments to the definition of "goods" sheds some light on the drafters' exclusion of "money in which the price is to be paid":

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.<sup>79</sup>

The exclusion of things or choses in action from the definition of "goods," although not explained by the drafters, dates back to the earliest drafts of the Code.<sup>80</sup> The drafters simply adopted the language employed by the Uniform Sales Act, the predecessor to Article 2, which defined "goods" to "include all chattels personal other than things in action and money."<sup>81</sup> The Sales Act's definition was itself lifted from the British Sale of Goods Act of 1894.<sup>82</sup> Since the exclusion of things or choses in action is over a hundred years old, the words should be read in light of their common law meaning. At common law, a thing or chose in action was a right to personal property that the owner does not possess.<sup>83</sup> The right to recover a

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76. See 1 ELIZABETH S. KELLY, *UNIFORM COMMERCIAL CODE DRAFTS* 177, 322 (1984) [hereinafter 1 KELLY].

77. U.C.C. § 2-102 (1993).

78. U.C.C. § 2-105(1) (1993).

79. U.C.C. § 2-105 official cmt. 1 (1993).

80. See *UNIFORM REVISED SALES ACT, PROPOSED FINAL DRAFT NO. 1*, reprinted in 2 ELIZABETH S. KELLY, *UNIFORM COMMERCIAL CODE DRAFTS* 16, 106 (1984) [hereinafter 2 KELLY]; *REPORT AND SECOND DRAFT, THE REVISED UNIFORM SALES ACT*, reprinted in 1 KELLY, *supra* note 76, at 322; *DRAFT OF A UNIFORM SALES ACT REVISED COPY OF EARLIER PORTION*, reprinted in 1 KELLY, *supra* note 76, at 262.

81. UNIF. SALES ACT § 76.

82. The Sale of Goods Act, 56 & 57 Vict., ch. 71, § 62(1) (1894) stated "goods include all chattels personal other than things in action and money, and in Scotland all corporeal movables except money."

83. BLACK'S LAW DICTIONARY 241 (6th ed. 1990).

debt, for example, is a chose in action.<sup>84</sup> Courts have also universally characterized a bank balance or credit as a thing or chose in action.<sup>85</sup>

In determining the applicability of Article 2, the issue then is whether the typical foreign exchange transaction, involving the exchange of a bank balance denominated in one currency for a balance denominated in another, should be characterized as a contract for a commodity or for a chose in action. If it is a contract for a commodity, the official comment to section 2-105<sup>86</sup> strongly supports the argument that the transaction lies within Article 2. If the transaction is, however, primarily an exchange of credits on a bank's books, Article 2's exclusion of things in action seems to apply.

Because the language of the Code is so similar to the British and Uniform Sales Acts, efforts to interpret these statutes are instructive. No court has ever considered whether foreign exchange transactions fall within the British Sale of Goods Act. The leading British treatise on sales law suggests, however, that a foreign exchange transaction involves the transfer of a chose in action.<sup>87</sup> Relying on eighteenth century criminal cases,<sup>88</sup> the treatise opines that foreign exchange transactions are not within the British Sales Act.<sup>89</sup>

In contrast to the British experience, a number of foreign exchange cases arose under the Uniform Sales Act. The earliest of these decisions presented the issue of whether a foreign exchange contract was enforceable under the Act's Statute of Frauds.<sup>90</sup> Unfortunately, while the definition of "goods" under the Sales Act excluded things in action,<sup>91</sup> the Statute of Frauds does not.<sup>92</sup> Since the Statute of Frauds in the Sales Act applies to both sales of goods and things in action,<sup>93</sup> courts issuing these early decisions did not need to draw a sharp distinction between the two. The decisions show, however, that courts tended to regard the obligation

84. *Id.*

85. 10 AM. JUR. 2D *Banks* § 338 (1963).

86. See *supra* note 79 and accompanying text.

87. BENJAMIN'S SALE OF GOODS 76 (A.G. Guest ed., 1st ed. 1974).

88. *Rex v. Leigh*, 168 Eng. Rep. 129 (1764) (foreign money is not "goods, wares or merchandise" within the meaning of a criminal statute).

89. See BENJAMIN'S SALE OF GOODS, *supra* note 87, at 76 n.59. Williston's discussion of the issue centers on *Equitable Trust Co. v. Keene*, 183 N.Y.S. 699 (Sup. Ct. 1920), *rev'd* 133 N.E. 894 (N.Y. 1922), discussed *infra* at notes 95-113. Williston also mentions that the Roman Law distinguished between a sale and an exchange or barter. 1 SAMUEL WILLISTON, WILLISTON ON SALES § 66b, 168 (rev. ed. 1948). The Code does not draw this distinction. Any transaction that passes title is a sale. U.C.C. § 2-106 (1993).

90. *Reisfeld v. Jacobs*, 176 N.Y.S. 223 (Sup. Ct. 1919); *Equitable Trust Co. v. Keene*, 183 N.Y.S. at 700.

91. UNIF. SALES ACT § 76.

92. UNIF. SALES ACT § 4 ("A contract to sell or a sale of any goods or choses in action of the value of five hundred dollars or upward shall not be enforceable by action . . . unless some note or memorandum in writing of the contract be signed by the party to be charged").

93. *Id.* The Uniform Commercial Code contains a statute of frauds for things in action as well. The provision is set forth in the General Provisions of the Code, Article One. U.C.C. § 1-206 (1993).

arising from a foreign exchange transaction as a chose in action.<sup>94</sup>

In a leading early case, *Equitable Trust Co. v. Keene*,<sup>95</sup> a dealer breached a forward contract to buy English pounds for dollars from an American bank.<sup>96</sup> When the bank sued, the dealer demurred to the complaint, raising the Statute of Frauds defense.<sup>97</sup> Consistent with the common practice for foreign exchange transactions, the parties made no written record of their bargain.<sup>98</sup> Counsel for the bank argued that no writing was necessary; the forward contract was an executory agreement to extend credit and thus lay outside the Sales Act's Statute of Frauds.<sup>99</sup> The trial court dismissed the argument, noting that "'credit' made available by one person upon himself for a commodity is merely a circumlocution for a sale or a contract to sell the article for future delivery."<sup>100</sup> The trial court refused to enforce the parties' agreement, because it found the contract was one for the future delivery of either a commodity or a chose in action and was therefore covered by the Sales Act's Statute of Frauds.<sup>101</sup>

The New York Court of Appeals reversed the trial court in an opinion featuring an odd line of legal reasoning but a healthy respect for commercial practice. The opinion initially states the court's awareness of the effect of its decision on foreign exchange operations.<sup>102</sup> The court noted that both parties agreed foreign exchange transactions were commonly conducted by "word of mouth,"<sup>103</sup> and that "a decision holding that an agreement for any such transfer must be evidenced by written memorandum" would produce "much inconvenience."<sup>104</sup> The court characterized the legal issue of whether the exchange fell within the Statute of Frauds as a "technical question"<sup>105</sup> and "a mere matter of nomenclature."<sup>106</sup> In giving the complaint a "natural interpretation" to avoid "technicalities and rather finely spun shades of meaning,"<sup>107</sup> the court agreed with bank counsel's characterization of the transaction. The court held that the exchange involved the future transfer of a bank credit and saw the parties' bargain as "an agreement to place a certain amount of foreign money to the credit of the defendant, which necessarily related to the future, whether measured by the celerity of a cable dispatch or by the delay of a

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94. See *Reisfeld v. Jacobs*, 176 N.Y.S. 223, 234 (Sup. Ct. 1919). The court stated that a contract for delivery of Russian bank notes involved the sale of a chose in action and was thus within the Statute of Frauds. *Id.*

95. 183 N.Y.S. 699 (Sup. Ct. 1920), *rev'd*, 133 N.E. 894 (N.Y. 1922).

96. 183 N.Y.S. at 699.

97. *Id.* at 699-700. The dealer also raised the interesting defense that the exchange agreement was an unenforceable wager or gambling contract. *Id.* at 700. The court summarily dismissed this claim. *Id.*

98. 133 N.E. at 894.

99. *Id.*

100. 183 N.Y.S. at 701.

101. *Id.*

102. 133 N.E. at 894.

103. *Id.*

104. *Id.*

105. *Id.* at 895.

106. *Id.*

107. *Id.* at 894.

communication by mail."<sup>108</sup> In other words, the court held that, because the agreement was an executory contract and not a present sale, it need not be in writing under the Statute of Frauds.

In reaching its decision, the court of appeals cited and praised an article on foreign exchange by Harlan Stone, then Dean of Columbia Law School and later Chief Justice of the United States Supreme Court.<sup>109</sup> Stone's article examines the commercial effect of an agreement to provide foreign exchange and contrasts that effect with the language commonly used to describe the exchange.<sup>110</sup> Stone notes that, although often described in words like "purchase" and "sale," a foreign exchange agreement is in reality an exchange of bank credit. To Stone, the transaction involved a *chose in action*:

Although banks do on occasion act as bailees in the physical transmission of money as in the case of the exportations and importations of gold made to equalize exchange, this is the exceptional and not the customary method of effecting transmission. No customer depositing money with a bank in order to effect payment at a distant point would be justified in expecting that the banker would physically transmit the money to the point of payment.

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When the transaction involves the banker's undertaking to procure the payment at a distant point the customer is often spoken of by bankers and in judicial opinion as having "purchased" exchange, but it is obvious that the term "purchase" when applied to such a transaction where the banker does not deliver a bill or draft to the customer is a mere figure of speech and all that the customer has actually purchased is the banker's undertaking or obligation to effect the payment at a distant point . . . . Thus the merchant or traveller who wishes to establish a credit in a foreign country and secures it by payment of money in dollars to his banker, speaks of having purchased pounds sterling, francs, or lire, as the case may be, although all that in fact or in law he has actually secured is some kind of an obligation by the banker to secure credit at the distant point payable in pounds, francs, or lire, as the case may be. Even when the obligation is performed and the credit is established, he is still only the owner of an obligation or *chose in action*, and not of any actual foreign money.<sup>111</sup>

Williston's treatise on the Law of Sales, the definitive scholarly work on the Sales Act, criticized the court of appeals' distinction in *Keene* between a transaction calling for an immediate performance and one calling for a future performance. According to Williston, the Sales Act expressly "applies to contracts to sell as well as sales."<sup>112</sup> Nevertheless, Williston agreed with the result in *Keene*. The form of the transaction was critical to Williston, and because the bank had made a London bank credit available to the dealer in the dealer's name, Williston thought the transaction

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108. *Id.* at 895.

109. *Id.*

110. Harlan F. Stone, *Some Legal Problems Involved in the Transmission of Funds*, 21 COLUM. L. REV. 507 (1921).

111. *Id.* at 512-14 (citations omitted).

112. 1 WILLISTON, *supra* note 89, § 67.

involved neither a good nor a chose in action.<sup>113</sup> Had the bank credit been made available to the dealer in the bank's name, however, Williston, like Stone, would have characterized the transaction as the sale of a chose in action.

Other New York decisions involving foreign exchange cite the Sales Act for widely accepted principles of law generally applicable in contract law. For example, in *Melzer v. Zimmerman*,<sup>114</sup> a currency dealer promised to sell Austrian kronnen to the plaintiff three months forward.<sup>115</sup> The plaintiff paid the dealer \$2,500, but the dealer never performed the contract.<sup>116</sup> The United States entered World War I shortly after the parties entered their agreement, and as a result, there was no ready market for the kronnen in the United States.<sup>117</sup> At trial, the dealer did not contest his liability for breach of contract. Consequently, the sole issue before the court was the amount of damages the plaintiff sustained.<sup>118</sup> In calculating and awarding damages, the court relied on the market price of kronnen quoted shortly before the market collapse.<sup>119</sup>

Interestingly, the *Melzer* court submitted to the jury the question of whether the contract was for actual currency or for a bank balance payable by a draft.<sup>120</sup> Had the jury not found that the parties had contracted for currency, the court apparently would have analyzed the case differently. The issue of how to categorize the transaction dictated the court's approach, even though the court understood that the Sales Act's damages provisions were "mainly declaratory of the common law."<sup>121</sup> The court applied the general remedial Sales Act principle that a contracting party should be liable for the market price of a commodity measured at the time the party has agreed to deliver it.<sup>122</sup> This principle is readily applicable to a currency exchange, whether one characterizes the transaction as the transfer of a bank balance or the sale of currency.

In later cases, the New York courts borrowed similar principles from the Sales Act in deciding disputes that involved foreign exchange. For instance, the New York Court of Appeals refused to enforce a vague agreement to purchase German marks absent a showing of custom or usage making the contract more definite.<sup>123</sup> In another case, the court of appeals determined recoverable damages by applying the principle that "damages suffered by delayed delivery [of Romanian currency] . . . are measured by the difference between the market value at the stipulated time of delivery and the market value at the time of the delayed deliv-

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113. *Id.*

114. 194 N.Y.S. 222 (Sup. Ct. 1922).

115. *Id.* at 223.

116. *Id.*

117. *Id.* at 224.

118. *Id.* at 223.

119. *Id.* at 224-25.

120. *See id.* at 223.

121. *Id.* at 224.

122. *Id.*

123. *Zimmerman v. Roessler & Hasslacher Chem. Co.*, 148 N.E. 659, 660 (N.Y. 1925).

ery."<sup>124</sup> Before citing the Sales Act, the judges deciding both of these cases characterized the foreign exchange transactions before them as commodity sales, even though they were citing general contract principles. The courts focused on this characterization issue instead of looking at the appropriateness of applying this statute in a foreign exchange transaction.

This manner of approaching the Code is contrary to that envisioned by Karl Llewellyn and other drafters of the U.C.C. Llewellyn foresaw judges reaching results based on "common practice and common sense"<sup>125</sup> rather than definitions or formal rules, an approach evident in the official comments to the definition of goods. Even though the statutory text excludes investment securities from Article 2, the comment states that the exclusion was not intended "to prevent the application of a particular section of this Article by analogy to securities . . . when the reason of that section makes such application sensible."<sup>126</sup> This comment first appeared in Llewellyn's 1944 draft of revisions to the Uniform Sales Act, a project that ultimately developed into the Uniform Commercial Code.<sup>127</sup>

The comment, as originally drafted, reflects Llewellyn's realist jurisprudence. Llewellyn thought judges in the late nineteenth century too often gave statutes a "wooden and literal reading" that frustrated legislative policies.<sup>128</sup> Llewellyn labelled this era the Formal Period, contrasting it with an earlier age of jurisprudence, exemplified by judges like Mansfield, Holt, and Cowen,<sup>129</sup> that Llewellyn referred to as "the Grand Style" of judicial decision.<sup>130</sup> Llewellyn admired and appreciated judges that respected commercial practice<sup>131</sup> and judicial decisions that avoided "enslavement to statutory language" and interpreted a statute like the Code "in terms of its sense and purpose."<sup>132</sup> Llewellyn felt that judges should feel free to expand the Code's reach if its principles should fit a transaction that lay outside its scope.<sup>133</sup> On the other hand, he did not want judges to apply a Code provision if its reason did not fit the commercial setting under consideration.<sup>134</sup> Llewellyn wanted judges to be con-

124. *Richard v. American Union Bank*, 170 N.E. 532, 535 (N.Y. 1930).

125. 1 KELLY, *supra* note 76, at 322.

126. U.C.C. § 2-105 cmt. 1 (1993).

127. 2 KELLY, *supra* note 80, at 106.

128. KARL LLEWELLYN, *THE COMMON LAW TRADITION* 374 (1960).

129. *See id.* at 373-74. The dedication page of *The Common Law Tradition* illustrates Llewellyn's great regard for the great judges of this earlier age: "To the undying succession of the Great Commercial Judges whose work across the centuries has given living body, toughness and inspiration to the Grand Tradition of the Common Law." *Id.* at dedication page.

130. *Id.* at 62-68, 373-74.

131. 1 KELLY, *supra* note 76, at 297, 299.

132. *Id.* at 305.

133. Llewellyn makes just this point in his comments to the Code's definition of goods by referring back to the official comments he drafted for the first section of his new Code. 2 KELLY, *supra* note 80, at 94. The Comment to the first section states a principle should "be extended where its reason and policy apply to a situation outside the explicit scope of the Code." *Id.* at 87.

134. "An express provision should be . . . limited where its reason does not apply." *Id.* at 87.

stantly mindful of the purpose of each section of the Code and the effects of applying each section in a commercial context,<sup>135</sup> and to respect commercial practice in a manner he felt the predecessor to the Code, the Uniform Sales Act, did not strongly encourage.<sup>136</sup> In short, neither Llewellyn nor any of the other principle drafters of the Code would apply any rule of Article 2 to a foreign exchange transaction unless it made commercial sense.

Several features of the judicial decisions under the Sales Act involving foreign exchange transactions would have appealed to Llewellyn. For example, he would have applauded the New York Court of Appeals' concern for commercial practice in *Equitable Trust Co. v. Keene*,<sup>137</sup> and would have appreciated the use of general remedial principles drawn from the Sales Act in cases like *Melzer v. Zimmerman*.<sup>138</sup> He would not, however, have had much regard for Williston's approach, which maintained that the form of a foreign exchange transaction should dictate whether or not it would lie within the Sales Act.<sup>139</sup> Llewellyn conversely thought transactions similar in commercial effect should be treated alike regardless of their form.<sup>140</sup> Llewellyn would also have rejected the manner in which courts under the Sales Act focused on the difference between the sale of a chose in action and the sale of a commodity.<sup>141</sup> As his comment concerning investment securities clarifies, Llewellyn believed courts should examine whether the reason for a rule fit a given transaction, rather than focus on the abstract question of how to characterize an exchange.<sup>142</sup>

Llewellyn's legal realism rejected the mode of legal thinking centering on the categorization of a problem in terms of legal concepts:

[C]ategories and concepts, once formulated and once they have entered into thought processes, tend to take on an appearance of solidity, reality, and inherent value which has no foundation in experience. More than this: although originally formulated on the model of at least some observed data, they tend, once they have entered into the organization of thinking, both to suggest the presence of corresponding data when these data are not in fact present, and to twist any fresh observation of data into conformity with the terms of the categories. This . . . is peculiarly troublesome in regard to legal concepts, because of the tendency of the crystallized legal concept to persist after the fact model from which the concept was once derived has disappeared or changed out of recognition. A simple but striking instance is the resistance opposed by the "master-servant" concept

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135. 1 KELLY, *supra* note 76, at 309.

136. *Id.* at 297, 299.

137. 133 N.E. 894 (N.Y. 1922). See *supra* notes 95-113 and accompanying text.

138. 194 N.Y.S. 222 (Sup. Ct. 1922). See *supra* notes 114-22 and accompanying text.

139. See *supra* notes 112-13 and accompanying text.

140. Llewellyn and Williston disagreed over the Code and had particularly sharp differences over the weight the courts should afford to commercial practice. Williston favored formal rules while Llewellyn would leave much to business usage. See TWING, *supra* note 1, at 287-89.

141. This is the type of question that the *Melzer* court submitted to the jury. See *supra* note 120 and accompanying text.

142. See *supra* note 126.



to each readjustment along the lines of a new industrial labor situation. The counsel of the realistic approach here, then, would be the constant back-check of the category against the data, to see whether the data are still present in the form suggested by the category-name. This slows up thinking. But it makes for results which mean something when one gets them.<sup>143</sup>

In his eulogy of Llewellyn, Grant Gilmore recalled Llewellyn's distaste for legal thinking that centered on what Llewellyn derisively called "lump concepts."<sup>144</sup> Llewellyn tried to draft the Uniform Commercial Code to channel legal analysis away from these concepts and towards fact questions like trade usage.<sup>145</sup>

Faced with a dispute involving foreign exchange, a judge employing Llewellyn's Grand Style should ask whether the rules of Article 2 fit the conduct of foreign exchange today, not whether the exchange is better categorized as one involving goods or a chose in action. The scope sections of the Uniform Commercial Code, however, did little to change the courts' approach towards the treatment of foreign exchange under the Code. While the official comment to the Code's definition of "goods" may urge a legal realist's approach, the text of the statute draws a categorical distinction between goods and things in action.<sup>146</sup>

The New York Law Revision Commission, appointed to study the Uniform Commercial Code prior to its adoption in New York, voiced concern that the Code's definition of "goods" would cause problems for foreign exchange transactions.<sup>147</sup> The Commission noted that a court could focus on the language in the official comments to support the view that foreign exchange transactions are commodity sales within the Article and thus apply the Code to an exchange.<sup>148</sup> The Commission cautioned that "the provisions of the Sales Article hardly seem designed to cope with foreign exchange transactions; perhaps they would be excluded from the Article on the ground that they . . . 'are things in action.'"<sup>149</sup>

As the Law Revision Commission Report makes clear, Llewellyn failed to resolve the characterization issue. Ironically, the decisions involving foreign exchange under the Uniform Sales Act were in some respects better examples of judging in Llewellyn's Grand Style than more recent decisions under the Uniform Commercial Code. These recent decisions have applied Article 2 to foreign exchange transactions with a surprising lack of reflection on how banks and others conduct foreign exchange.

The decisions involving foreign exchange since New York's adoption of the Uniform Commercial Code have all taken the approach that the

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143. Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431, 453-54 (1930).

144. Grant Gilmore, *In Memoriam: Karl Llewellyn*, 71 YALE L.J. 813, 814 (1962).

145. *Id.*

146. See *supra* notes 80-85 and accompanying text.

147. 1 STATE OF NEW YORK LAW REVISION COMMISSION REPORT, STUDY OF THE UNIFORM COMMERCIAL CODE 361-62 (1955).

148. *Id.* at 362.

149. *Id.*

Law Revision Commission feared. These decisions have held, without much discussion, that Article 2 applies to currency transactions because the transactions involve money traded as a commodity, not as a medium of exchange.<sup>150</sup> The decisions rely on the comment to the Code's definition of "goods," which the Law Revision Commission predicted would cause confusion.<sup>151</sup> The decisions do not consider the alternative interpretation (favored by the Law Revision Commission and many authorities, including Harlan Stone, under the prior Sales Act) that foreign exchange involves the transfer of things in action. More fundamentally, they do not explain why the Code's rules make commercial sense in a foreign exchange transaction.

Many arguments can be made in favor of applying the Code to the issues presented by these cases. For example, in two cases decided in 1991 and 1992, two separate courts applied the Code's parol evidence rule to confirmation slips generated in currency swaps.<sup>152</sup> The Code allows a more concise confirmation slip between merchants than the New York common law.<sup>153</sup> Therefore, application of the Code's merchant rules to currency swaps makes sense. Sophisticated traders, who have developed a practice of respecting their parol bargains as binding agreements, conduct these swaps, and by recognizing the binding effect of the slip, the decisions provide more comfort to traders than the New York common law. In a market as active as the foreign exchange market, finality of the kind offered by the slip is a paramount concern.<sup>154</sup> The courts issuing these decisions, however, made no attempt to justify their application of the Code to these transactions, but instead stated simply: "There seems to be no question that the U.C.C. applies to foreign currency transaction[s]."<sup>155</sup>

This type of approach reached the limits of good sense in *In re Koreag, Controle et Revision, S.A.*,<sup>156</sup> a 1992 decision of the U.S. Second Circuit

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150. See, e.g., *Saboundjian v. Bank Audi (U.S.A.)*, 556 N.Y.S.2d 258, 261 n.2 (App. Div. 1990); *United Equities Co. v. First Nat'l City Bank*, 383 N.Y.S.2d 6 (App. Div. 1976).

151. See *Saboundjian*, 556 N.Y.S.2d at 261 n.2.

152. *Compania Sud-Americana de Vapores, S.A. v. IBJ Schroder Bank & Trust Co.*, 785 F. Supp. 411 (S.D.N.Y. 1992) (applying New York law); *Intershoe, Inc. v. Banker's Trust Co.* 571 N.E.2d 641 (N.Y. 1991).

153. The Code renders irrelevant evidence that contradicts memoranda exchanged by contracting parties to confirm the terms of their agreement. U.C.C. § 2-202. The formal requirements for such memoranda are minimal when exchanged between merchants. The Code only requires that a confirmatory memoranda be "some writing sufficient to indicate a contract for sale has been made." U.C.C. § 2-201(1), (2).

By contrast, under the parol evidence rule of the New York common law, a confirmatory memorandum must completely and accurately evince the parties agreement. *Donald Friedman & Co., Inc. v. Newmah*, 174 N.E. 703, 704 (N.Y. 1931). Generally if the memorandum does not state clearly that it is the full and final expression of the parties agreement, parol evidence will be admitted to show the memorandum was mistaken. *Dubin v. Fashion Knitting Mills*, 194 N.Y.S.2d 320, 322 (App. Term 1959). See James M. Cain, *Does the Intershoe Case Fit All Swap Confirmations?*, 10 INT'L FIN. L. REV. 39 (1991).

154. Indeed, the Code's rules probably do not close a transaction soon enough. See *infra* notes 163-69 and accompanying text.

155. *Compania Sud-Americana de Vapores, S.A.*, 785 F. Supp. at 431 n.19 (quoting *Intershoe, Inc.*, 571 N.E.2d at 644).

156. 961 F.2d 341 (2d Cir.), *cert. denied*, 113 S. Ct. 188 (1992).

Court of Appeals. In that case, a New York firm, engaged in currency swaps with a Swiss Bank, wired nearly \$6.9 million dollars to the Swiss Bank's account in New York.<sup>157</sup> In return, the firm was to receive an equivalent amount in foreign currency.<sup>158</sup> The New York firm also transferred \$4.1 million dollars worth of foreign currency to the Swiss bank and was to receive dollars in return.<sup>159</sup> Swiss banking authorities, however, closed the Swiss bank before it could transfer the dollar and foreign currency balances that represented its end of these swaps.<sup>160</sup> The banking official charged with liquidating the Swiss bank sought to recover the bank's balances held in New York,<sup>161</sup> but the New York firm also claimed the balances.<sup>162</sup>

The Second Circuit applied Article 2 of the Uniform Commercial Code in reaching its decision. "In a currency exchange," the court reasoned, "money is not the *medium* of exchange, but rather the *object* of exchange. Such currency thus constitutes 'goods' . . . subject to the Code."<sup>163</sup> The court consequently permitted the New York firm to reclaim the \$6.9 million balance it had wired to the Swiss bank's account as a reclaiming seller.<sup>164</sup> Under Article 2, a seller who has shipped goods on credit to an insolvent buyer can recover the goods if the seller demands their return within ten days.<sup>165</sup> Nevertheless, the court did not permit the New York firm to recover the foreign balances it had transferred<sup>166</sup> because it considered the New York firm a "buyer" of dollars in this swap and, therefore, held that the firm had no right to reclaim the \$4.1 million. However, the court did not explain what prevented the firm from reclaiming the foreign currency it had exchanged as a "seller" in this transaction. Moreover, and far more troubling, the opinion shows no appreciation for the difficulties that the reclaiming seller rule presents for foreign exchange.

As described above, most foreign exchange trades take place on the spot market<sup>167</sup> and have maturities of less than two days.<sup>168</sup> Fully two-thirds of the forward trades have maturities of less than a week.<sup>169</sup> In this trading environment, the ten days that the Code allows a seller to reclaim goods is an eternity. No judge would lightly allow a seller to reclaim real estate that was the subject of a transaction made decades ago; too many transfers made in reliance on apparent title would have occurred. In the foreign exchange market, a similar number of trades made in reliance on

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157. *In re Koreag*, 961 F.2d at 345.

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 355.

164. *Id.* at 356.

165. U.C.C. § 2-702(2) (1993).

166. *In re Koreag*, 961 F.2d at 357.

167. See *supra* note 18 and accompanying text.

168. See *supra* note 19 and accompanying text.

169. See *supra* note 26 and accompanying text.

an earlier exchange can occur in just a few hours. The foreign exchange market thus depends upon a rigorous finality.

The drafters of Article 4A recognized the importance of finality in electronic funds transfers—the means chosen to settle most foreign exchange transactions. Under Article 4A, a beneficiary of a funds transfer is entitled to payment once the beneficiary's bank has accepted a payment order.<sup>170</sup> In *In re Koreag*, this occurred when the New York bank holding the Swiss bank's account accepted the New York firm's transfers.<sup>171</sup> The *Koreag* decision thus conflicts with Article 4 and with modern payments law. The decision compares unfavorably with *Equitable Trust Co. v. Keene*,<sup>172</sup> decided seventy years earlier, in which the New York courts first applied sales law to foreign exchange transactions. Unlike the *Koreag* court, the judge in *Keene* carefully noted that the case did not involve a negotiable instruments issue.<sup>173</sup> The conflict between Article 4A and *In re Koreag* has led the Payments Sub-committee of the American Bar Association's Uniform Commercial Code Committee to recommend that the Permanent Editorial Board issue a practice commentary stating that, in the event of a conflict between Article 2 and 4A, Article 4A should control.<sup>174</sup>

Ironically, *In re Koreag* went wrong where earlier decisions involving the parol evidence rule went ostensibly right.<sup>175</sup> Those decisions appear to establish a principle favoring finality in the law of foreign exchange.<sup>176</sup> If these decisions had explicitly articulated such a rationale, they might have provided guidance for the *Koreag* decision. Yet, neither these decisions nor *Koreag* offer any reasons for applying the rules of Article 2 to foreign exchange, nor do they evince any concern for commercial practice in the foreign exchange markets. Instead, the decisions display a mechanical kind of legal reasoning; everything in these decisions hinges on the characterization issue, and nothing could be further from Llewellyn's plans for the Code. For this reason, the cases offer some lessons to the drafting committee engaged in the revision of Article 2.

### III. Suggestions For The Revision of Article 2

Article 2's scope provisions simply do not state clearly enough Llewellyn's vision of how courts should approach the Code. As we have seen, Llewellyn did not want the courts to feel unduly fettered by the language of the Code.<sup>177</sup> If the Code stated a rule or a definition that had become out-

170. U.C.C. § 4A 4-404(a) (1993).

171. *In re Koreag*, 961 F.2d at 345.

172. 183 N.Y.S. 699 (Sup. Ct. 1920), *rev'd*, 133 N.E. 894 (N.Y. 1922).

173. 133 N.E. at 894. *See also* *Melzer v. Zimmerman*, 194 N.Y.S. 222, 223 (Sup. Ct. 1922) (jury finds parties contracted for currency and not a bank balance transferred by a draft).

174. THOMAS BAXTER & CATHY SCARBOROUGH, OUTLINE OF REPORT OF SUBCOMMITTEE ON PAYMENTS CONCERNING THE APPLICATION OF THE UNIFORM COMMERCIAL CODE TO A FOREIGN EXCHANGE TRADE (2nd Discussion Draft 1993).

175. *Intershoe, Inc. v. Banker's Trust Co.*, 571 N.E.2d 641 (N.Y. 1991).

176. *See supra* notes 152-55 and accompanying text.

177. *See supra* notes 128-36 and accompanying text.

dated as a result of commercial developments, he wanted courts to disregard the rule or definition.<sup>178</sup> For example, even though Article 2 expressly excludes investment securities transactions, he wanted courts to feel free to apply the principles of Article 2 to such a transaction if it made commercial sense.<sup>179</sup> Similarly, he believed courts should not apply a Code provision to a transaction if it was commercially unreasonable to do so, even if the transaction lay within the express scope of the Code.<sup>180</sup> Above all, he wanted courts to articulate their reasons for applying or refusing to apply the Code. He hoped these reasons would guide future decisions, giving the Code consistency without undue inflexibility in the manner of the common law.<sup>181</sup>

The language of Article 2's scope section does not direct the courts to approach the Code in a common law manner. The scope language—"unless the context otherwise requires, this Article applies to transactions in goods"—was added to the Code in 1955 to address criticisms that the Article should be expressly limited to sales of goods.<sup>182</sup> To some extent, the phrase "unless the context otherwise requires" permits a court to expand or narrow the article's reach as Llewellyn had envisioned.<sup>183</sup> As the Study Group Report noted, however, the phrase is too ambiguous to give courts much direction.<sup>184</sup> Several Study Group members favor a scope section similar to one proposed in 1982 for the Canadian Sale of

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178. 1 KELLY, *supra* note 76, at 309 ("[T]he Draft seeks to make plain that when circumstances unmistakably and persistently show the obsolescence of a policy declared in the Act, the Courts are free to move in the common-law manner toward cure.").

179. U.C.C. § 2-105 cmt. 1 (1993).

180. This approach is most clearly stated in the scope section of Article 5:

This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

U.C.C. § 5-102(3) (1993).

181.

It is not where the *words* [of a Code provision] leave off, but where the *reason* leaves off, that the provision is to find its limit. The borders need to be left open for new cases of similar reason, as yet unimagined.

....

The Draft [of the Sales Act] proceeds upon the proposition that if the reason in life of a situation be clearly grasped and stated, and the reason of its solution be made clear to the courts, there results both immediately and over the long haul a more reckonable course of decision and a more reckonable body of interpretation than can be had by any other statutory device which is not to be overhauled and rebuilt every two years or five.

1 KELLY, *supra* note 76, at 306-07 (emphasis in original); see also *id.* at 309 ("[T]he Court may either develop or limit the principles laid down in the Act . . . in the common law manner.").

182. See SUPPLEMENT NO. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS OF THE UNIFORM COMMERCIAL CODE, reprinted in 17 ELIZABETH S. KELLY, UNIFORM COMMERCIAL CODE DRAFTS 355-56 (1984); 1 STATE OF NEW YORK LAW REVISION COMMISSION REPORT, *supra* note 147, at 355-56.

183. See 1 STATE OF NEW YORK LAWS REVISION COMMISSION REPORT, *supra* note 147, at 723 (statement of Prof. Pasley).

184. STUDY GROUP REPORT, *supra* note 1, at 40.

Goods Act.<sup>185</sup> The Canadian proposal would strictly limit the Article's reach to sales of goods but would permit a court to apply any provision of the Article to other transactions "if relevant in principle and appropriate in the circumstances."<sup>186</sup> This approach would require a court faced with a transaction other than the outright sale of hard goods to state its reasons for extending the reach of the Code, thus allowing the opinion to guide future decisions. Had the parole evidence decisions on foreign exchange articulated a principle favoring finality, the *In re Koreag* court would have been forced to consider this principle in its decision. This approach is better than the existing Code language, but the revision should, as much as possible, avoid hinging a question about the Article's scope on characterization questions. The question should not be whether the transaction involves goods, services, choses in action, money, or commodities, but whether the rules of the article make sense under the circumstances.

The drafting committee might also wish to consider what does not belong in a revised Article 2. This approach was adopted in Article 9 of the Code, which has a general scope section but also contains a list of specific exclusions.<sup>187</sup> The drafting committee would be wise to include foreign exchange in an Article 2 exclusion list. Foreign exchange is international in a way the sale of goods is not; it should not be regulated with state law like the Code.

Other existing bodies of law already regulate foreign exchange activities,<sup>188</sup> and adding Article 2 to the mix will likely cause some peculiarities. No one would suggest that Article 2, for example, should apply to trades on the floor of the Chicago Commodities Exchange. A currency futures contract purchased on the exchange, however, is in many respects functionally equivalent to a forward contract for hedging financial risk. If a forward contract is subject to Article 2 but a futures exchange is not, a great deal hinges on what is purely a matter of form. This approach, reminiscent of Williston, was rejected by Llewellyn and other drafters of the Code.

Moreover, the Code's rules of form appear inordinately outdated when applied to foreign exchange transactions. The statutes of frauds set forth in Articles One<sup>189</sup> and Two<sup>190</sup> require signed writings for agreements to be enforceable. While the Code defines the term "writings" rather broadly,<sup>191</sup> the term does not seem to encompass an audio tape of a

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185. *Id.* at 42 n.9. Although this proposal was first made in 1982, it has never been enacted. *Id.*

186. *Id.*

187. U.C.C. § 9-104 (1993).

188. *See, e.g.*, 31 C.F.R. pt. 128 (1993) (reporting requirements); 12 C.F.R. pt. 208, app. A (1993) (risk-based capital adequacy guidelines for member banks of the Federal Reserve System); 12 C.F.R. pt. 225, app. A (1993) (guidelines for bank holding companies); 12 C.F.R. § 3 (1993) (guidelines for national banks); 12 C.F.R. § 567 (1993) (guidelines for thrifts); 12 C.F.R. § 325 (guidelines for federally insured, state-chartered banks); 7 U.S.C. §§ 1-24 (1993) (future and options regulation).

189. U.C.C. § 1-206 (1993).

190. U.C.C. § 2-201 (1993).

191. U.C.C. § 1-201 (46) (1993) ("any ... intentional reduction to tangible form.")

bargain reached by telephone or a record of a transaction reached over a modem<sup>192</sup> because the Code requires the writing to be "signed."<sup>193</sup> A party to a foreign exchange transaction can avoid a statute of frauds problem to some degree by sending a confirmatory memorandum to a counter-party,<sup>194</sup> but even this device is ill-suited to foreign exchange as it is practiced today. As we have seen, most foreign exchange is conducted by professional traders who make their bargains by telephone or increasingly over linked computer screens. Seconds after concluding a transaction they enter into another in reliance on their position. Even a confirmatory memorandum secured the next day may come too late—yet the Code allows ten days.<sup>195</sup> For these reasons, the New York State Bar Association Committee on Banking Law has recommended legislation that would relieve the uncertainty that the Code's statutes of frauds create for foreign exchange agreements by permitting parties to enter into enforceable contracts over the telephone, by computer, or through other means of electronic communication.<sup>196</sup>

Finally, if the revision leaves the definition of goods unchanged, a new article should, at a minimum, resolve issues related to the settlement of a foreign exchange transaction under the payments articles: Articles 3, 4 and particularly 4A. Article 2 remedies like the reclaiming seller rule have the potential seriously to undermine finality of payment, an important principle in all modern payment systems, and particularly in electronic funds transfers.

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192. See, e.g., *Roos v. Aloï*, 487 N.Y.S.2d 637, 642-43 (Sup. Ct. 1985) (tape recording does not satisfy the U.C.C. statute of frauds).

193. The Code defines the term "signed" to require a party to affix a signature or other symbol with a "present intention to authenticate a writing." U.C.C. § 1-201 (39) (1993).

194. U.C.C. § 2-201(2) (1993).

195. *Id.* Ironically, most foreign exchange trades would fare better under the original Statute of Frauds of 1677, which exempted agreements to be performed within a year.

196. See Denis M. Forster ed., *Memorandum in Support of Legislation, in SWAPS AND OTHER DERIVATIVES IN 1993*, *supra* note 39, at 97.